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AUTHOR McCall, H. Carl
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ABSTRACT

The recent defeat of New York's statewide School Facilities Bond Act did not eliminate the pressing need for additional funds for school capital needs. This report discusses ways in which the state can meet these needs, shows how "backdoor" borrowing is not an acceptable method of financing school facilities needs, and describes methods for allocating additional funds. It explores ways to acquire building aid for critical projects, particularly under the "building aid formula," which calculates reimbursements based on a varying proportion of expenses incurred. It is recommended that, because the aid formula for distributing funds has been recently revised, any additional aid should be provided strictly on a needs basis, such as in remedying fire, health, and safety problems. The report also recommends a special process that could be used for granting 100 percent reimbursement for the most critical projects in school districts with average or below-average resources; a two-step procedure for this process is outlined. Minor maintenance aid will also need to be addressed, but it is pointed out that aid amounts available for most districts are relatively small in comparison with current maintenance spending. Suggestions for other reform actions are presented. (RJM)

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H. CARL McCALL
STATE COMPTROLLER

A.E. SMITH STATE OFFICE BUILDING
ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

Meeting School Facilities Needs

A CONCEPTUAL PROPOSAL

FOR CONSIDERATION IN THE 1998-99 BUDGET

State Comptroller
H. Carl McCall

DECEMBER 17, 1997

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Meeting School Facilities Needs

The recent defeat of the statewide School Facilities Bond Act did not eliminate the pressing need for additional funds for school capital needs. Already, there have been calls for some sort of substitute measure. Following is a conceptual proposal from Comptroller McCall for consideration in the 1998-99 budget.

Source of Funds

Backdoor borrowing is not an acceptable method of financing school facilities needs, particularly in light of the voters' rejection of the proposed debt issuance. However, the current year surplus, which is now growing substantially beyond initial projections, is a good alternative source of revenue. Surplus funds are an ideal method of funding a one-time statewide capital grant program, because they match one-time resources with one-time needs. Much of the 1997-98 surplus derives from financial market activities, and thus may not represent recurring revenues.

It is now estimated by the Executive that the 1997-98 year-end surplus is likely to be at least $500 million more than was projected at the time of budget enactment. These funds could be directed to school facilities needs over the next several years through additional building and maintenance aid, as described below.

Method of Allocating Additional Funds

Additional funds can be directed to facilities, on a temporary basis, through two vehicles: (i) additional building aid for capital projects provided on a needs-prioritized basis, and, (ii) increased minor maintenance aid, but with some reforms in that formula. Additionally, the recently enacted provisions that limit building aid reimbursements on debt service to minimum amortization periods (e.g.,15 years for new construction) should be undone — they have the effect of encouraging districts to take on longer-term debt than they might otherwise.

Additional Building Aid for Critical Projects

Construction and renovation projects undertaken by school districts are aided as part of school aid under the building aid formula. This formula reimburses districts for a varying proportion of expenses incurred (either cash expenditures or debt service). The building "aid ratio" is the percentage of costs which are reimbursed (up to a maximum cost allowance); the ratio varies based on school district wealth and the average reimbursement ratio is 67 percent. This year changes were made to this aid formula that will increase the aid ratios for all districts by 10 percent, and recognize varying regional costs in the calculation of maximum cost allowances.[1]

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[1] See *School Facilities, Conditions, Problems and Solutions* (State Comptroller's Office, October 1997), pp. 13-15 for a description of this aid formula; a description of the recent changes to this formula can be found on p. 19.

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Since this legislation has already enriched the aid formula across the board for all districts, any additional aid should be provided strictly on a needs basis, considering both the relative importance of the needs (based on objective criteria), and school district wealth. This aid could be provided in addition to the regular building aid apportionment, through an increased aid ratio, and districts meeting the most extreme criteria for need could receive state reimbursement for up to 100 percent of costs. The additional aid could be provided on a sliding scale aid ratio, with the 100 percent reimbursement reserved for districts at middle-wealth levels and below.

Because this program would leave the existing building aid formula in place, and only the most critical needs would receive the additional aid, all school districts could therefore continue with their regular programs. The State Education Department (SED) would evaluate projects for eligibility based on objective criteria. Although a complete model for this approach would have to be developed administratively, the criteria should essentially determine whether there are critical needs there that must be addressed immediately, and that would not in all likelihood be otherwise addressed in a timely fashion. These would include fire, health and safety needs, deficiencies in structural or mechanical conditions, and severe dilapidation and overcrowding

Projects meeting the objective criteria would be prioritized or ranked based on an index of relative need, and the available funds would then be allocated. This approach is similar to the Assembly proposal for allocating the Bond Act proceeds and the 1996-97 Executive Budget proposal for a limited pool building aid allocation.

An expedited special process would have to be used for granting 100 percent reimbursement for the most critical projects in school districts with average or below-average resources. The regular maximum cost allowance would not apply to such projects to ensure that 100 percent was funded, and in substitution the State could have a greater role in contract approval and management. This could be handled either through the State Education Department (although it is likely that additional staffing would be required) or through one of the State's construction management public authorities. These projects could then be implemented without local borrowing or voter approval (as normally required in school districts outside the big five cities). For projects not accepted for full state pickup, school districts could still move forward through the regular building aid program.

This would be a two-step procedure which would work as follows:

Step 1: Local school districts would determine if they have projects eligible for additional aid, or 100% funding. Objective criteria for project eligibility would be published by SED, including district wealth. Based on the published project criteria and their wealth level, districts would have a good idea if they were eligible for additional aid and/or full state pick-up, even before they apply (although the process would allocate a limited amount of funds). All applications would be due by a specific date, and so could be considered and ranked through a unified review.

Step 2: Through an administrative process, the State Education Department would determine which projects could receive 100% funding, or full state pick-up, and which projects could receive additional funding (short of 100%). This process would be based on school district wealth and on the relative severity of need.

Districts with projects not eligible for full state pick-up would proceed as they usually do with building projects, although they could possibly receive some additional aid for those projects that qualify. Since the overall needs cannot be completely evaluated until a process is in place and school districts have submitted their requests, there would be an advantage to allowing an administrative determination of how much of the additional funding should go for full state pickup projects, and how much should go to projects of a less critical nature or projects in wealthier school districts, which would be eligible for additional aid but not for 100 percent funding.

Those school districts with projects eligible for full state pick-up would plan for their projects under an alternate procedure, with the construction management handled differently (and also perhaps with the State as the contracting entity).

Although this is a conceptual proposal, the following table provides a more specific example as to how the allocations might be determined. Some form of sliding scale of this nature would be required, although the precise wealth levels and aid ratios in the following example are provided solely to illustrate how such an aid mechanism could be constructed.

Sample Approach for Additional Aid on a Sliding Scale for Critical Projects

District Wealth (as measured by current building aid formula)	Current Aid Ratio (with 10% enrichment)	Additional Aid for Critical projects under a Sliding Scale	Maximum Combined Percentage Reimbursed (critical needs)	Is district eligible for 100% funding?
2 times average wealth	10%	Not Available	10%	No
1.5 times average wealth	34%	maximum 10%	46%	No
average wealth	59%	10 to 41%	100%	Yes
½ average wealth & below	85%	minimum 15%	100%	Yes

Minor Maintenance Aid

The aid amounts available for most districts under this new $50 million program are relatively small in comparison with current maintenance spending. Since a lack of maintenance has

consistently been identified as a large part of the current facilities problems, it might also be advisable to increase the aid available through this program, at least on a temporary basis.[2]

This formula is largely based on two data elements: average building age and enrollment growth from 1989-90 to 1993-94. The average building age is weighted by building square footage and uses some relatively dated figures that have never been fully examined for accuracy. Enrollment growth from 1989-90 to 1993-94, although relatively accurate, is certainly not the most recent data available. This data was the same as that used in the 1994-95 minor maintenance allocation (at which time it was fairly recent). The formula aid allocation is highly sensitive to either of these items, and a relatively small variation in either causes a huge differential in aid received. An improved allocation could be provided by considering district wealth and using more current, and longer-term enrollment trends.[3]

Removing the Minimum Amortization Periods in Building Aid

Another change that should be considered is to undo one of the building aid formula changes made in the 1996-97 budget. This legislation was primarily intended to limit the State's liability for unanticipated increases in the building aid entitlement, but it has had the unintended consequence of encouraging all school districts to incur longer-term debt, rather than paying off projects more quickly, if they are able to do so. The provisions enacted in 1996-97 specified that — to be eligible for aid — debt service payments would have to be at least the length of a minimum period of amortization. These minimum periods are 15 years for new construction or 10 years for reconstruction, rehabilitation or improvement of existing facilities. If debt obligations are issued for less than the minimum period, aid is calculated based on an assumed amortization schedule. As noted, the minimum amortization period change has the effect of discouraging school districts from paying off debt quickly. This effect has now been documented — the issuance of long-term bonds was up sharply last year, and there was a corresponding decrease in short-term debt issuances.[4]

Other Reforms

Additional aid can help to meet the critical needs which have accumulated. However, beyond remedying existing needs, substantial changes must be made in the underlying system in which school building and maintenance decisions are made, because the system itself tends to encourage deferred maintenance and, eventually, greater capital expenditures. The incentives therefore must

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[2] See *School Facilities, Conditions, Problems and Solutions* (State Comptroller's Office, October 1997), pp. 20-21 for a description of this new aid program; Appendix II of that report (p. 30) provides a detailed estimate of the aid available under this program by school district and a listing of some of the underlying input data.

[3] In Appendix II of *School Facilities, Conditions, Problems and Solutions*, there is data available for each school district comparing the enrollment over the period 1989-90 to 1993-94 (the data used in the current formula), as opposed to 1989-90 to 1996-97 (a more appropriate long-term trend).

[4] "N.Y. Schools' Seesaw: Bond Issuance Up, Notes Down," *The Bond Buyer*, August 25, 1997.

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be countered by a combination of better enforcement of existing regulatory requirements, and improved statewide and local capital planning and reporting. Following is a summary of the Comptroller's key recommendations for change.[5]

- ✓ Capital planning in school districts and statewide can be improved through effective implementation of the Capital Assets Preservation Plan (CAPP) program.

- ✓ Mandate relief actions to decrease the cost of school construction and rehabilitation should be considered, including state rules governing asbestos remediation and the Wicks law. Cost-effective construction can also be encouraged through the application of proven-effective methods such as value engineering and life-cycle cost analysis.

- ✓ Better reporting of facility conditions, and the utilization of performance measures could provide enhanced accountability and improve conditions and efficiency of maintenance and construction expenditures.

- ✓ The existing required annual inspections in school buildings — even when effectively carried out — focus on major structural problems or fire and safety issues. They do not effectively ensure that school buildings are properly maintained.

Given these underlying problems, it would be prudent to make proper maintenance and capital planning a prerequisite for receipt of the additional building and maintenance aid. As noted in previous Comptroller's reports and audits, even the existing law requirements are not being adequately followed in many cases.

The additional aid as proposed above would be helpful in remedying what has become an emergency situation statewide. In the long term, however, it should be acknowledged that aid formulas are not a good means of making local budgetary allocations.[6] The provision of additional aid for maintenance may be a helpful temporary measure, but the longer term solution to improper and deferred maintenance issues must go beyond providing more aid and encompass the elements of reform outlined above.

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[5] See *School Facilities, Conditions, Problems and Solutions* (State Comptroller's Office, October 1997), for a full description of these issues.

[6] The Comptroller's aid formula reform agenda, as described in *An Agenda for Equitable and Cost-Effective School Finance Reform* (October, 1996) calls for establishing a simplified "block grant" approach to school aid. As a general principle, numerous aid formulas reimbursing multiple purposes are inadvisable from an efficiency perspective. Several proposals have recently been made to reimburse maintenance expenditures in a manner similar to that used for building aid. This approach, although it would be helpful in removing the existing fiscal incentive for capital rather than maintenance expenditures, is not advanced here because it is inconsistent with the block grant approach, and it would likely have adverse consequences outweighing its positives. Capital expenditures, if they are to be aided directly, must use a reimbursement basis; this approach for operating expenditures should be avoided whenever possible.